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# STANDING COMMITTEE ON PUBLIC ACCOUNTS

## FINANCIAL SERVICES COMMISSION OF ONTARIO — PENSION PLAN AND FINANCIAL SERVICE REGULATORY OVERSIGHT

(Section 3.03, 2014 Annual Report of the Auditor General of Ontario)

1<sup>st</sup> Session, 41<sup>st</sup> Parliament  
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The Honourable Dave Levac, MPP  
Speaker of the Legislative Assembly

Sir,

Your Standing Committee on Public Accounts has the honour to present its Report and commends it to the House.

Ernie Hardeman, MPP  
Chair of the Committee

Queen's Park  
June 2015

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STANDING COMMITTEE ON PUBLIC ACCOUNTS  
COMITÉ PERMANENT DES COMPTES PUBLICS  
Toronto, Ontario M7A 1A2



# STANDING COMMITTEE ON PUBLIC ACCOUNTS

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## **PREAMBLE**

On March 11, 2015 the Standing Committee on Public Accounts held public hearings on a value-for-money audit (Section 3.03 of the Auditor General's *2013 Annual Report – Financial Services Commission of Ontario – Pension Plan and Financial Service Regulatory Oversight*) of the pension and financial service regulatory oversight of the Financial Services Commission of Ontario (FSCO).

The Committee endorses the Auditor's findings and recommendations, and presents its findings, views, and recommendations in this report. The Committee requests that FSCO provide the Clerk of the Committee with written responses to the recommendations within 120 calendar days of the tabling of the report with the Speaker of the Legislative Assembly, unless otherwise specified.

## **Acknowledgements**

The Committee extends its appreciation to officials from FSCO who appeared before the Committee on March 11, 2015. The Committee also acknowledges the assistance provided during the hearings and report writing deliberations by the Office of the Auditor General, the Clerk of the Committee, and staff in the Legislative Research Service.

## **BACKGROUND**

FSCO is accountable to the Ministry of Finance and responsible for regulating pension plans, the insurance industry, the mortgage brokerage industry, credit unions and caisses populaires, loan and trust companies, and cooperative corporations.

FSCO protects the public interest and enhances public confidence in Ontario's regulated financial sectors through registration, licensing, monitoring, and enforcement.

Within FSCO, the Pension Division administers and enforces the *Pensions Benefits Act* and related regulations. Each employer who sets up a pension plan in Ontario is required to register the plan with FSCO, as well as comply with reporting and fiduciary requirements. The Licensing and Market Conduct Division administers and enforces requirements of legislation that applies to the financial services sector.

## **AUDIT OBJECTIVES AND SCOPE**

The objective of the audit was to assess whether FSCO had effective systems and procedures in place for its regulation of pension plans and financial services to

- ensure compliance with relevant legislation and FSCO policies established to protect the public interest and to enhance public confidence; and
- measure and report on the effectiveness of its regulatory oversight.

The audit included interviews with FSCO management and staff, and reviews and analysis of related files and examinations conducted by FSCO; registration, licensing, and enforcement databases; and policies and procedures. Meetings were held with representatives of the federal Office of the Superintendent of Financial Institutions and several industry stakeholders. Senior FSCO management agreed with audit objectives and criteria.

## **ISSUES RAISED IN THE AUDIT AND BEFORE THE COMMITTEE**

While a number of issues were raised in the audit and before the Committee, it is noted that FSCO provided answers to many questions in advance of meeting with the Committee. The Committee considers the issues below to be of particular importance.

### **Underfunding of Defined-benefit Pension Plans**

In light of increasing underfunding of defined-benefit pension plans in Ontario, the Auditor recommended that FSCO should conduct an analysis of

- the reasons for this increase;
- the potential for plans to recover, based on a variety of predictions of economic growth in the province over the next several years; and
- the financial exposure to the province should the underfunding situation not improve in the next few years.

In response to the Auditor's recommendations, FSCO is currently collecting research to analyze underfunding trends, with the goal of determining future potential risks and identify possible mitigation strategies.

FSCO noted that since the Auditor reviewed the underfunding issue the situation has improved (from 92% of plans being unfunded in December 2013 to 78% of plans in December 2014) and is expected to continue to improve unless interest rates fall further or investment returns are below expectations.

### **Committee Recommendations**

The Standing Committee on Public Accounts recommends that:

- 1. FSCO identify strategies to help inform and mitigate financial risk of underfunded plans, including potential impact of varying levels of economic growth.**
- 2. Based on these identified strategies, FSCO provide the Ministry of Finance with recommended legislative changes.**

## Sustainability of Pension Benefit Guarantee Fund

The Auditor found that while designed to be self-financing through annual premium charges to pension plans, the Pension Benefit Guarantee Fund (PBGF) has required significant loans and grants to cover claims pay-out. The Auditor recommended that FSCO assess PBGF financial risk exposure to potential claims and its continuation as an insurer of single-employer defined-benefit pension plans, and use this information to recommend further possible changes to the *Pensions Benefits Act* and regulations to address the sustainability of the PBGF.

In response to the Auditor's recommendations, FSCO stated that it is reviewing the PBGF and will consider what additional analysis is available to improve the monitoring of the fund and incorporate expanded disclosure in the financial statements of the fund to better reflect plan exposure.

It was noted that FSCO does not have a mandate to determine how the PBGF operates or how it should be funded – this responsibility lies with government under the *Pensions Benefits Act*. FSCO also highlighted previous studies that examined the PBGF.<sup>1</sup> Following government changes to assessment rules FSCO has seen a significant influx of revenue to the PBGF.<sup>2</sup> This is occurring as the number of claims on the PBGF has been dropping. Currently, the PBGF has a surplus of \$375 million. However, as of March 31, 2014, the accumulative solvency deficiency was at \$28.9 billion, covering 1,834 plans.

## Committee Recommendations

The Standing Committee on Public Accounts recommends that:

- 3. FSCO complete analysis of ways to improve monitoring of the PBGF, such as developing risk indicators for the fund, and incorporate expanded disclosure in the financial statements of the fund to better reflect plan exposure.**
- 4. FSCO provide recommended changes to the *Pensions Benefits Act* and associated regulations based on this analysis.**

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<sup>1</sup> *Public Services for Ontarians: A Path to Sustainability and Excellence* (also referred to as the Drummond Report) and *Looking Ahead – Projecting Ontario's Pension Benefits Guarantee Fund* both discussed the sustainability of the PBGF, with the latter doing so in significant detail.

<sup>2</sup> PBGF assessment changes took effect January 1, 2012:  
<https://www.fSCO.gov.on.ca/en/pensions/pbGF/Pages/2012PBGFchanges.aspx>

## Limited Powers of the Superintendent

Finding that FSCO has few powers to address administrators of underfunded pension plans, the Auditor recommended that FSCO seek changes to the *Pension Benefits Act* to provide for increasing powers (similar to those held by the federal Office of the Superintendent of Financial Institutions), as well as improve plan monitoring and proactive follow-up action for late filings.

FSCO acknowledged that increasing powers similar to its federal counterpart would be beneficial and noted that pending legislation would grant these powers. The Committee notes that this legislation, Bill 120, the *Securing Pensions Now and for the Future Act, 2010*, has received Royal Assent, but has not been enacted pending development of required regulations. FSCO is also identifying areas where it would be effective to have monetary penalties for enforcement purposes.

Regarding monitoring and late filings, FSCO has created a pension oversight section to more effectively deal with plans that are delinquent in their filings. FSCO notes that as of March 2015, all delinquent filings referred to in the Auditor's report are up to date, with no filings more than a year out.

## Committee Recommendations

The Standing Committee on Public Accounts recommends that:

5. **FSCO identify the powers that the Office of the Superintendent of Financial Institutions has that FSCO does not, as well differences in plan administrators' mandatory reporting, such as requiring annual actuarial reports from plans that are funded less than 120%, and provide the Committee an analysis of the risks of not having similar powers and requirements.**
6. **FSCO identify and recommend areas where monetary penalties would be effective for enforcement purposes.**

## Examination of Plans

The Auditor found that FSCO conducted on-site examinations of 11% of underfunded plans in 2013. The examinations that were conducted did not adequately cover significant areas (e.g., whether investments complied with federal investment rules).

FSCO noted that it will evaluate whether more examinations can be conducted with existing resources. It will also collect additional data to assess risks and identify if there are additional risks in the areas of investments that need to be monitored.

FSCO also highlighted that the number of at-risk plans has decreased since December 2013 as financial outlooks improved (similar to plan underfunding), and that it is not FSCO's intent to look at 7,000 pension plans. Rather, FSCO employs a risk-based approach to conducting on-site examinations.

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## Committee Recommendation

The Standing Committee on Public Accounts recommends that:

- 7. FSCO provide an update on whether more examinations can be conducted with existing resources and the changes it plans to make to its examinations methodology to ensure key risks are covered.**

## Enhanced Disclosure to Members on Plan Performance

The Auditor found that the information provided by plan administrators to members and made public by FSCO is lacking. It was recommended that FSCO seek to implement improvements to statutory annual disclosure requirements of plan administrators to provide more meaningful information to members, as well as reassess FSCO's annual public reporting on pension plans to provide more useful information, including how a plan's performance and expenses compares to other plans in Ontario.

FSCO is currently identifying new information to provide as part of its annual disclosure to members and will make recommendations to the government in this regard, as well as seek new information about FSCO's activities that can be shared with plan members.

## Committee Recommendation

The Standing Committee on Public Accounts recommends that:

- 8. FSCO complete its analysis of new information plan administrators can provide to members and make recommendations to government, as well as the new information FSCO can make public regarding its annual public reporting on pension plans.**

## Weak Oversight of Co-operative Corporations

To improve oversight and better protect members and investors of co-ops, the Auditor recommended that FSCO seeks new legislative authority under the *Co-operative Corporations Act* to ensure all board members have criminal checks completed before a co-op is registered, FSCO list all approved offering statements on its website, FSCO conduct ongoing monitoring of co-ops, and ensure that fees charged to co-ops for the review of offerings statements are commensurate with FSCO costs. The Auditor found that it costs FSCO \$500,000 to manage the co-op sector while receiving \$1,000 in fees.

FSCO noted that while responsibility for legislative reviews rests with the government, FSCO will make recommendations to the government regarding the fee co-ops pay to FSCO for reviewing their offering statements. FSCO will also be initiating further discussion with the Ontario Securities Commission regarding sharing or transferring responsibility for reviewing these statements.

## Committee Recommendations

The Standing Committee on Public Accounts recommends that:

- 9. FSCO work with the Ministry of Finance to identify regulatory amendments as required to ensure that**
  - a. all co-op board members have criminal checks before the co-op is registered and offering statements are issued;**
  - b. all approved offering statements are listed on FSCO's website; and**
  - c. FSCO conduct ongoing monitoring of co-ops.**
- 10. FSCO provide the government with recommendations regarding the level of the fees it collects for reviewing co-op offering statements.**
- 11. FSCO provide an update on discussions with the Ontario Securities Commission on the benefits of sharing or transferring responsibility of reviewing offering statements.**

## Licensing

To ensure that FSCO's licensing system and procedures are effective and that only qualified agents are given licences, the Auditor recommended FSCO:

- ensure its online licence system can identify and reject licences for agents who do not meet requirements;
- establish agreements with all agents' errors and omission (E&O) insurance providers to give FSCO timely information on agents compliance and consumer claims against agents; and
- investigate all agents who do not meet minimum standards.

FSCO indicated that it is currently developing a program to better support data-gathering, internal controls, and improve risk assessment. Development of this program began in January 2015.

A data steward position is being created to manage system data related to licensing. FSCO will also examine how to create agreements with insurers to receive data on which agents have purchased E&O insurance.

A pilot of insurance on-site examinations (including E&O insurance verification) is underway. FSCO also notes that it is not required to continuously verify E&O insurance, but takes a risk-based approach to monitoring that includes sample audits. These audits have shown that there is a low risk of non-compliance and that most agents have E&O insurance. Finally, FSCO noted that they are developing a system to notify agents in advance of the expiration of their E&O insurance.

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## Committee Recommendation

The Standing Committee on Public Accounts recommends that:

### 12. FSCO provide an update on:

- a. **implementation of programs to support data-gathering, internal controls and risk assessment related to the licensing system; and,**
- b. **agreements with insurers related to receiving data on which agents have purchased E&O insurance, as well as insurance that has lapsed.**

## Market Conduct

To ensure that FSCO is meeting its mandate of protecting the public interest and enhancing public confidence in regulated financial sectors, the Auditor recommended that FSCO:

- investigate complaints in a timely manner, and ensure procedures are in place to monitor and follow up on handling of complaints;
- assess the need for proactive investigations in each regulated sector to allow for periodic examinations of all registrants and licenses;
- identify common issues from examination activity and share these with the industry, as well as consider what can be done to mitigate their causes; and
- establish procedures to identify, investigate, and determine the continued suitability of registrants and licensees who have received sanctions from other associations.

FSCO indicated that it is currently developing a framework to document how it identifies, assesses and deploys resources, as well as reviewing performance standards in order to provide more timely publication of compliance and examination reports to the industry.

FSCO is also putting in place enhanced processes to monitor timeliness and outcomes of complaints and ensure sanctioned licenses are assessed more quickly. FSCO received 325 complaints in 2013. It noted that there is no automatic revocation or suspension allowed due to actions taken by other regulators, and FSCO must follow due process investigating these instances.

The Committee raised questions related to the role of managing general agents (MGA) within the insurance framework. An MGA is an “an individual, partnership or corporation that holds at least one direct brokerage contract with a life insurance company registered to do business in Canada.”<sup>3</sup>

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<sup>3</sup> Canadian Council of Insurance Regulators, *Issues Paper: Managing General Agencies Life Insurance Distribution Model* (2011), p. 6.

FSCO noted that while it has not done a specific review of MGAs, it supports a review by the Canadian Council of Insurance Regulators, and that the existence of MGAs does not relieve insurance companies of their obligation to ensure that agents (including MGA) who represent them operate in compliance with the law. FSCO does not feel there are currently any regulatory gaps created by MGAs.

### **Committee Recommendation**

The Standing Committee on Public Accounts recommends that:

**13. FSCO provide an update on:**

- a. the implementation of its framework that documents how FSCO identifies, assesses and deploys compliance resources;**
- b. steps taken to monitor timeliness and outcomes of complaints and ensure holders of sanctioned licenses by other regulators that also hold FSCO licences are assessed quickly;**
- c. its assessment of the need for proactive investigations in each regulated sector to allow for periodic examinations of all registrants and licenses; and**
- d. how FSCO will provide more timely publication of compliance and examination reports to the industry.**

### **Potential Benefits to Transferring Regulatory Oversight**

The Auditor recommended that FSCO examine the transfer of responsibilities for protecting the public interest and enhancing public confidence to new or established self-governing industry associations by working with the Ministry of Finance for consideration of necessary legislative changes.

FSCO noted that the financial services marketplace is now a highly interconnected financial services environment, and that as an integrated regulator FSCO is best positioned to monitor this marketplace for risks, conduct the appropriate licensing, monitoring and enforcement, provide government with advice, and protect the public interest.

FSCO also noted that a previous report, the *Public Services for Ontarians: A Path to Sustainability and Excellence* (also referred to as the Drummond Report), suggested consideration be given to rationalizing and consolidating programs that regulate interrelated sectors, which is in line with current trends and modern regulation that calls for a holistic view of regulating financial sectors.<sup>4</sup>

### **Committee Recommendation**

The Standing Committee on Public Accounts recommends that:

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<sup>4</sup> Ontario, Commission on the Report of Ontario's Public Services, *Public Services for Ontarians: A Path to Sustainability and Excellence* (2012), p. 393.

**14. FSCO provide a formal recommendation on:**

- a. the transferring of some responsibility for protecting the public interest and enhancing public confidence to new or established self-governing industry associations; and**
- b. the transferring of regulatory responsibilities for regulated financial sectors to the federal Office of the Superintendent of Financial Institutions.**

## **CONSOLIDATED RECOMMENDATIONS**

- 1. FSCO identify strategies to help inform and mitigate financial risk of underfunded plans, including potential impact of varying levels of economic growth.**
- 2. Based on these identified strategies, FSCO provide the Ministry of Finance with recommended legislative changes.**
- 3. FSCO complete analysis of ways to improve monitoring of the Pension Benefit Guarantee Fund, such as developing risk indicators for the fund, and incorporate expanded disclosure in the financial statements of the fund to better reflect plan exposure.**
- 4. FSCO provide recommended changes to the *Pensions Benefits Act* and associated regulations based on this analysis.**
- 5. FSCO identify the powers that the Office of the Superintendent of Financial Institutions has that FSCO does not, as well differences in plan administrators' mandatory reporting, such as requiring annual actuarial reports from plans that are funded less than 120%, and provide the Committee an analysis of the risks of not having similar powers and requirements.**
- 6. FSCO identify and recommend areas where monetary penalties would be effective for enforcement purposes.**
- 7. FSCO provide an update on whether more examinations can be conducted with existing resources and the changes it plans to make to its examinations methodology to ensure key risks are covered.**
- 8. FSCO complete its analysis of new information plan administrators can provide to members and make recommendations to government, as well as the new information FSCO can make public regarding its annual public reporting on pension plans.**
- 9. FSCO work with the Ministry of Finance to identify regulatory amendments as required to ensure that**
  - a. all co-op board members have criminal checks before the co-op is registered and offering statements are issued;**
  - b. all approved offering statements are listed on FSCO's website; and**
  - c. FSCO conduct ongoing monitoring of co-ops.**

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10. FSCO provide the government with recommendations regarding the level of the fees it collects for reviewing co-op offering statements.
  11. FSCO provide an update on discussions with the Ontario Securities Commission on the benefits of sharing or transferring responsibility of reviewing offering statements.
  12. FSCO provide an update on:
    - a. implementation of programs to support data-gathering, internal controls and risk assessment related to the licensing system; and,
    - b. agreements with insurers related to receiving data on which agents have purchased E&O insurance, as well as insurance that has lapsed.
  13. FSCO provide an update on:
    - a. the implementation of its framework that documents how FSCO identifies, assesses and deploys compliance resources;
    - b. steps taken to monitor timeliness and outcomes of complaints and ensure holders of sanctioned licenses by other regulators that also hold FSCO licences are assessed quickly;
    - c. its assessment of the need for proactive investigations in each regulated sector to allow for periodic examinations of all registrants and licenses; and
    - d. how FSCO will provide more timely publication of compliance and examination reports to the industry.
  14. FSCO provide a formal recommendation on:
    - a. the transferring of some responsibility for protecting the public interest and enhancing public confidence to new or established self-governing industry associations; and
    - b. the transferring of regulatory responsibilities for regulated financial sectors to the federal Office of the Superintendent of Financial Institutions.